

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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Postal Rate and Fee Changes, 2000

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY
Docket No. R2000-1

REPLY BRIEF OF THE
NEWSPAPER ASSOCIATION OF AMERICA

September 22, 2000

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The Newspaper Association of America ("NAA") hereby submits its reply brief in this proceeding. NAA will address only the following issues:

- The Standard (A) Enhanced Carrier Route pound rate;
- The appropriate level of institutional cost contributions for Standard (A) ECR mail and First Class mail; and
- City carrier cost attribution.

Before addressing these issues, however, NAA must say that it is struck by the spectacle of Advo and its direct mail colleagues wrapping themselves in the cloak of helping free "newspapers."¹ While we stand second-to-none in our appreciation for the role that both free and paid newspapers play in American society,² we must note that the particular papers SMC and MOAA tout are not newspapers, but "shoppers." The difference between a newspaper and a shopper is that while both serve the advertising community, the advertising profits from newspapers subsidize editorial content, while the advertising profits from shoppers do not. This distinction is not only one of

¹ SMC Br. at 44; MOAA et al. Br. at 26.

² NNA, our fellow newspaper association, of course stands equal to us in its appreciation of the role of newspapers in American society.

fundamental importance for our democracy, but it also is a distinction that has been recognized by Congress and the courts.

NAA members – who do publish extensive editorial content – also spend hundred of millions of dollars on Standard (A) ECR mail annually. Thus, and despite Advo and its direct mail colleagues' presumption to speak for the newspaper industry, NAA does not oppose Postal Service's rate reductions for ECR mail lightly. However, NAA does believe that neither its members' interests nor the best interests of the Postal Service are furthered when the Service continues to exploit captive First Class mailers or take sides in the battle for the advertising dollar.

NAA does not lightly lift to a constitutional level the question of the federal government's authority to intentionally drive revenue out of newspapers. Rather, we do so as a large customer of the Postal Service, only after much thought and consideration, and only after years of watching inappropriate behavior on the part of the Postal Service. The Postal Service's actions over the last twenty years has raised the matter.

I. THE RECORD DOES NOT SUPPORT A DECREASE IN THE STANDARD A ENHANCED CARRIER ROUTE POUND RATE

Although one would never know it from the briefs of MOAA, PostCom, DMA, SMC, and AISOP, the pound rate for above-breakpoint Standard (A) ECR mail has declined steadily by about 8 percent in real terms since 1995. Despite this significant decline, the Postal Service in this case proposes to reduce the pound rate by up to 12 percent further while overall rates would rise by more than 6 percent, and First Class rates would rise across the board.

The burden of proof is on the Postal Service to justify why mailers of heavy ECR pieces are singled out for this selective reduction. NAA addressed in its initial brief the fundamental failure of the Postal Service to meet its burden. Nothing in the briefs warrants a different conclusion.

A. The Cost Arguments Are Unpersuasive

In its initial brief, NAA pointed out that the Postal Service has once again failed to comply with the Commission's longstanding request for a comprehensive study of the effect of weight on costs in Standard (A) mail. NAA further showed that the Postal Service's "distribution key analysis"— which provides the sole cost "support" for the proposed pound rate reduction in this case – should be rejected as unresponsive and because it fails to provide the "reliable cost evidence" necessary to justify a reduction in the pound rate. See *Opinion and Recommended Decision*, Docket No. R97-1 at 403, ¶ 5425 ("R97-1 Op.").

Nothing in the many efforts of the Postal Service or direct mailers suffices to fix the distribution key analysis. Humpty-Dumpty is indeed broken and can't be put back together again. First, several parties rest their hopes on the regression trend lines drawn by witness Daniel, or on variations thereof.³ Significantly, not even the Postal Service – the sponsor of that testimony – placed any weight on Ms. Daniel's regressions. Mr. Moeller did not use them and Dr. Bozzo called them "superfluous." Tr. 44/19513 (Bozzo).

³ In so doing, they implicitly concede that the Daniel distribution was deficient as filed.

MOAA *et al.* (Br. at 7) rely on Mr. Prescott's calculation of a "cost per pound" rather than cost per piece analysis, which is also flawed. In a bizarre oxymoron, they assert (at 7-8) that as "shown by witness Prescott's alternate analytic approach, there is no reason to eliminate or otherwise manipulate the data for particular weight intervals." But manipulation of the Daniel's data for particular weight intervals is exactly what Prescott's alternate analytic approach does. He uses no data points other than those presented by Ms. Daniel. Tr. 44/19274 and 19329 (Prescott). Moreover, Mr. Prescott's analysis produces nonsensical results when only pound-rated pieces are considered, which is the proper basis to consider when setting pound rates.⁴ This is evident from Mr. Prescott's own Exhibit 1B, in which the average cost per pound from mailings weighing 3.5 ounces and higher shows a gyrating pattern at best. Tr. 44/19322.

SMC offers several variations of the Daniel regressions with adjustments intended to account for presortation and dropshipping. SMC Br. at 15-16. As noted in NAA's initial brief, as well as that of Val-Pak/Carol Wright, however, these regressions still depend on the underlying Daniel's flawed data. Further manipulation of the data cannot solve this fundamental problem. Ms. Crowder's attempt to justify the lower pound rate through analyses that did not rely on witness Daniel's disaggregated unit cost data, while done on an aggregate basis, suffer from the same flaw beyond her control. Treating the data in aggregated form does not produce more or better data.

⁴ See Tr. 30/14705 (Tye) (stating that only the costs of pieces above the breakpoint should be used in setting the pound rate). Even MOAA *et al.* appear to concede this point at 14, noting that a regression should be based on the mix of volumes to which it applies. Tr. 44/19393 (Prescott).

Finally, SMC discusses Ms. Crowder's unweighted regression of her derived cost data. SMC Br. at 22-23. SMC argues that, under her regressions, "the costs of ECR flats do not increase nearly as steeply as the proposed rates." However, this is normal. Because the proposed rates include a percentage-based markup, the slope of the rate line necessarily is steeper than the cost line.

Contrary to *MOAA et al.* (Br. at 11), Dr. Bozzo's rebuttal testimony (which attempts to show that the sampling variation in the Daniel testimony was small) proves little. Dr. Bozzo's testimony amounts to saying that virtually all of the tallies recorded for ECR mail were at the lower weight levels. It does not cure the thinness of tallies at the higher weight levels, which would receive the largest rate reduction. It merely illustrates how disproportionately weighted towards lighter pieces the IOCS tallies actually are.

Several parties also rely on their belief that the costs of ECR mail must not nearly double as weight doubles. Again, the only data for that proposition is that underlying the insufficient Postal Service distribution key analysis. However, as NAA noted in its initial brief, similar reasoning applies to First Class mail as well, and the criticism merely identifies a possible flaw in postal rate design. But singling out ECR mail for relief is plainly discriminatory on its face.

B. The Attacks On The Newspaper Industry From Its Competitors Miss The Point

NAA went to some length in its initial brief to point out, once again,⁵ that newspapers compete with saturation mailers, not the Postal Service. As NAA witness

⁵ E.g., Reply Brief of the Newspaper Association of America, Docket No. R97-1 at (Continued...)

Wilson (a representative of one of Miami's largest mailers) explains, their competition is for advertising and, in the case of newspapers, it is for advertising that provides the financial support for their editorial products. Newspapers become very concerned when the federal government appears to take sides – whether through improper motives or through unsupported rate proposals – in the competitive battle between newspapers and saturation mailers. This concern has Constitutional significance because the government has no business intentionally making proposals designed to reduce newspapers' advertising revenue, and thus the editorial content which that advertising revenue pays for.⁶

Evidently not getting it, a number of parties freely mischaracterize NAA's testimony as alleging competitive harm.⁷ Neither NAA nor Dr. Tye – nor, for that matter, Mr. Wilson – have alleged competitive harm. NAA made that unmistakably clear in its Objection to Interrogatory USPS/NAA-2(b), filed on August 21, 2000, where it stated that it was not claiming competitive harm and that “[t]hese are good times for us [newspapers], just as they are good times for our competitors.” NAA Objection to

(...Continued)

1 n.2 (April 10, 1998) (“The notion that an agency of the federal government would or should align with one group of mailers, or view newspapers as somehow less a part of the postal system than, say, saturation mailers, is offensive”).

⁶ In its brief, the Postal Service argues that NAA has misrepresented its motives, citing its own carefully worded direct testimony disclaiming any competitive intent. USPS Br. at VII-178 to 179. This is wholly unconvincing. Not only does the Postal Service have a long history of targeting newspaper advertising, but the rebuttal testimony of Dr. O'Hara is replete with comparisons of newspapers and postage rates.

⁷ USPS Br. at VII-178; MOAA *et al.* Br. at 3, 23-24; AISOP Br. at 14-23.

USPS/NAA 2(b) at 3. An Advo press release touting record growth and revenue growth of 13% for its third fiscal quarter of 2000 was attached to that objection.

This is in sharp contrast to the situation of the alternate delivery industry. The test for alleging competitive harm is "an economically reasonable apprehension of material competitive injury." *Opinion and Recommended Decision*, Mailing Online Experiment, Docket No. MC2000-2 at 35 (June 21, 2000). AAPS has certainly satisfied this test.

The direct mailers point out that neither NAA nor Dr. Tye have presented data showing that advertising has shifted from newspapers to ECR mail.⁸ That is correct. The Postal Service did.

As NAA witness Tye demonstrates, the Postal Service's *own direct case* rests in part on evidence showing that some of ECR mail's recent volume increase would not have occurred if ECR rates had remained constant in real terms and if newspapers' prices had not changed. Tr. 30/14847-48 (Tye).⁹ If that cross-elasticity based on historical data is wrong, then the Postal Service volume projection formula is faulty.¹⁰

⁸ See MOAA *et al.* at 24. Dr. Tye's purpose was to critique the Postal Service's proposals, not offer his own evidence.

⁹ As Mr. Wilson's testimony shows, this shift has resulted in the American public receiving less news and other editorial information." Tr. 44/19150 (Wilson). That statement stands unrebutted in either testimony or brief.

¹⁰ This fact alone suggests that the Commission should not place excessive weight on Mr. Harding's rebuttal testimony. There is a conflict between Mr. Harding's anecdotal data with the Postal Service's volume forecasts.

SMC argues that the relative economic health of the newspaper industry (currently, at least) should preclude us from arguing that the Postal Service should not lower the pound rate. Does that mean that the record economic prosperity of Advo and the saturation mail industry should preclude them from arguing that the Postal Service should not raise the pound rate? Of course not. Both propositions are equally absurd.¹¹

C. The Unjustified Reduction In The Pound Rate Would Reduce Editorial Content In Newspapers

NAA does contend, as Mr. Wilson explains, that reducing the pound rate would directly lead to a reduced amount of editorial content in newspapers. This is a public policy concern that the Commission properly should consider under, *inter alia*, Criterion 4, which directs the Commission to consider the effect of rate changes on “the general public [and] business mail users [which unquestionably includes NAA members].” The distribution of less editorial information is to the detriment of the American public.

D. The Preprint Advertising Market Is Highly Competitive

Contrary to several parties on brief, the record shows that the preprint market is highly competitive and that saturation mailers are thriving despite the allegedly “excessive” pound rate. As Mr. Wilson and Mr. Baro made clear, competitors in the

¹¹ Interestingly, MOAA, DMA, and PostCom seem to be making their own “competitive harm” claims by asserting that “Current Pound Rates are Having a Significant Negative Effect Upon Business Mail Users.” MOAA *et al* Br. at 18. But those parties presented no evidence showing any negative effect of the pound rates on anyone. Indeed, the Advo press release showing a 13% increase this last quarter and 15 straight months of record profits counters this.

preprint market include large and small newspapers, Advo, Harte-Hanks's *Flyer*, Val-Pak/Carol Wright, and thousands of other entities. Similarly, newspaper insert rates correspond to those charged by Advo, Harte-Hanks, Mr. Bradpiece's PennySaver, and so on.¹² Mr. Harding's testimony confirms this as well.

Yet, in an interesting twist of logic, direct mailers argue that newspapers are ineffective competitors to saturation mail, fail to serve small businesses, and that lower pound rates are necessary to salvage Mom and Pop retailers. This is nonsense. As Mr. Wilson's testimony (conveniently ignored by MOAA *et al.*) shows, the vast majority of print media serve small as well as large business. In today's market, direct mailers and newspapers—both large and small—target to the zip code or below in order to serve businesses, both small and large. AISOP even appears unfamiliar with the testimony of its own witness concerning this point, as Mr. Baro of Harte-Hanks conceded: "I could not possibly list all of the various media *The Flyer* competes with in Dade and Broward Counties without spending hundreds of hours researching the topic." Tr. 30/14403; *accord* Tr. 44/18912-19 (Bradpiece).

AISOP counsel's extensive cross-examination of Mr. Wilson did little other than to illustrate the intensity of this competition in the Miami market. For example, the record clearly shows that both the *Miami Herald* (through its *Herald Card*) and the *Flyer* (and Advo) can distribute a lightweight piece at similar prices per household. Tr.

¹² Contrary to MOAA *et al.* (Br. at 25), not one witness supporting the Postal Service proposal offered a scintilla of testimony as to the prices they charge their customers or to substantiate their claim that newspaper prices are lower than theirs.

44/19292-93 (Wilson) (citing 2.5 to 4 cents); Tr. 30/14412 (Baro) (citing rate of 2.96 cents for light-weight piece).¹³

Despite the arguments of counsel on brief that direct mailers are suffering badly from the "excessive" pound rate,¹⁴ the record shows that pound-rated ECR mail is flourishing as never before at current rates. The most recent data shows that pound-rated ECR (which is said to be suffering from "excessive" rates) is increasing substantially.¹⁵ Chicken Little lives.

E. Reducing The Pound Rate Would More Likely Benefit Mailers Than Advertisers

Significantly, nary a word appears in the direct mailers' briefs claiming that reducing the pound rate would benefit advertisers. This is not surprising. It is the direct mailers themselves that hope to claim the benefit by driving millions of dollars "to the bottom line" (Tr. 44/19003) (Guiliano), rather than passing cost savings on to advertisers.

¹³ AISOP argues on brief (at 6) that Mr. Wilson's testimony about the Herald's TMC rates differs from the Herald's rate card at AISOP LR 1. This is no surprise to anyone who read, or listened to, his testimony. Mr. Wilson plainly stated that the Herald's TMC rates are separate from, and lower than, the newspaper insert rates.

¹⁴ A view not shared by SMC and AISOP witnesses who testified that today's saturation rates are reasonable (Tr. 30/14546 (Smith) and Tr. 32/15661 (Merriman)).

¹⁵ Compare USPS-LR-I 436 (hybrid billing determinants) with USPS-LR-I-166 (FY98 billing determinants).

II. STANDARD (A) ENHANCED CARRIER ROUTE MAIL SHOULD BEAR A LARGER SHARE OF THE POSTAL SERVICE'S INSTITUTIONAL COSTS

For many years First Class mail has borne a grossly disproportionate burden of the Postal Service's institutional costs. NAA's initial brief explained how the Commission could alleviate some of this unfair burden in this proceeding. Predictably, direct mailers oppose any effort to alleviate that burden by shifting a larger share of the costs to Standard (A) mail.

A. The Statutory Pricing Criteria Support Lowering First Class Mail's Cost Contributions And Increasing The Institutional Cost Contribution Of Standard (A) ECR Mail

Both DMA and MOAA assert that First Class mail should pay substantially more institutional costs than Standard (A). In fact, it does. Although one would never know it from the DMA and MOAA briefs, Standard (A) mail currently makes far *smaller* contributions to the Postal Service's institutional costs than First Class mail.

Comparing the per-piece contributions makes this starkly clear. Using the Commission's cost methodology and BY98 costs, the TYAR First Class unit contribution is 17.5 cents, more than double that of ECR mail (8.19 cents). What MOAA (Br. at 2) and SMC (Br. at 4) refer to as the "high" unit contribution of ECR mail is dwarfed by what could only be called the mountainous contribution of First Class mail. Eight cents cannot credibly be called "high" when most of the mail pays 17 cents. In fact, First Class letters contribute a much larger share of institutional costs (\$16.84 billion) than

commercial Standard (A) combined (\$4.5 billion). This total First Class contribution alone is double the total *attributable* costs of all commercial Standard (A) mail.¹⁶

Thus, to the extent DMA and MOAA contend that the statutory ratemaking criteria justify First Class mail making a larger contribution to institutional costs than Standard (A) mail, this already occurs. And while NAA believes that the gap between First Class and Standard (A) mail should narrow rather than widen, First Class mail would continue to pay the lion's share of the costs even under NAA's proposal.

DMA and MOAA's mistake illustrates the misleading nature of comparing cost coverage percentages (which reflect differing degrees of worksharing between First Class and Standard (A) mail) rather than the actual unit contributions. As the Commission determined in Docket No. R97-1, expressing institutional cost contributions in percentage terms can be misleading when comparing subclasses made up of mail with different levels of worksharing.

The only measure by which Standard (A) ECR mail appears to make a larger contribution than First Class mail is the illusory one of percentage cost coverage markups. Whether considered on a unit basis or in the aggregate, Standard (A) ECR mail pays far less of the institutional costs of the Service than First Class mail. This gap should narrow.

¹⁶ Revenue: Exhibit USPS-32E (amended Aug. 3, 2000) (Mayes); Attributable costs: Tr. 17/6710 (Kay) (Commission methodology).

B. The Commission May Properly Consider Historical Institutional Cost Inequities In Setting Rates

DMA argues that the Commission's longstanding desire to alleviate the disproportionate institutional cost burden on First Class mail has "no continued relevance in this case" and that the Commission's previously stated goals cannot be lawfully relied upon to support its decision. While it is understandable that that DMA would wish to ignore continuing First Class institutional costs inequities, neither case law nor common sense supports its position.

In Docket No. R87-1, the Commission recommended higher First Class rates and stated:

Our decision to recommend rates which result in coverage for First-Class which is somewhat above the average should be recognized as a one time variation from the historic, near average level we continue to believe best reflects the policies of the Act. In future cases we expect First-Class to return to that traditional level.¹⁷

The Commission is legally entitled to follow this policy preference in this case, so long as it considers the impact of any changes that may have transpired since the previous rate case. For example, in *Mail Order Ass'n of America v. U.S. Postal Service*, 2 F.3d 408 (D.C. Cir. 1993) ("MOAA"), the Court of Appeals affirmed a decision by the Commission to effectuate a policy objective to achieve "equal or near equal cost coverages or markups for [First Class mail] and BRR, at or near the systemwide average."¹⁸ The Court upheld the Commission's decision, finding it appropriate for the

¹⁷ R87-1 Op. at 400 n.14.

¹⁸ 2 F.3d at 425.

Commission “to lessen what it viewed as inequities in existing rates and render fairer the relative institutional cost burdens borne by BRR and first class mail, the two largest classes.”¹⁹ Thus, the Commission may rely upon its previously stated goals, to the extent that those goals respond to evidence, as exists in this case, that First Class mail continues to bear an excessive share of the institutional cost burden of the postal system.

DMA and MOAA also argue that the statutory criteria, specifically criterion 2, require that First Class have a higher cost coverage than ECR because First Class mail has a higher value of service. Undeterred by a lack of evidence of actual service, DMA relies instead on delivery standards (DMA Br. at 3), although these say nothing about what service is actually received. But this record provides no basis for such a comparison, because the Postal Service has no data on the service performance of Standard (A) mail.²⁰ Indeed, there is every reason to suspect that destination entered ECR mail gets good, even day-certain, service. See Tr. 5/1762 (Kingsley) (stating that ECR and First Class mail receive same delivery service after being merged).

DMA also argues that the Commission’s oft-expressed desire to move the relative contributions of First Class and Standard (A) mail closer together are inoperative today due to changed e-mail and postal reclassification. DMA Br. at 8. This strains credulity. Alternatives to First Class mail have existed for many, many years,

¹⁹ *Id.* at 426.

²⁰ See also CRPA/USPS-T6-16(d) (USPS has no data indicating the extent to which Periodicals class mail is delivered within applicable service standards).

yet the legal monopoly remains effective. And contrary to DMA, the Commission's concerns about the perennial imbalance in institutional cost contribution has continued beyond reclassification. See *R97-1 Op.* at 276, ¶ 5047 and 302, ¶ 5120.

C. The Commission Should Place No Weight On Ramsey Pricing Estimates

MOAA contends that the Postal Service's Ramsey pricing presentation is "reliable, and unchallenged" (MOAA Br. at 10) (emphasis in original) and that the time has come to base rates on Ramsey concepts. Both statements are incorrect.

Not only has the Commission routinely rejected Ramsey pricing, but MOAA completely overlooks Dr. Tye's demonstration that the Postal Service's Ramsey presentation is hopelessly flawed and deserves no weight. Tr. 30/14769-70 (Tye). MOAA also apparently does not consider that Postal Service witness Thress has abandoned the contention, upon which Mr. Bernstein relied, that the estimated own-price elasticity of ECR mail has changed since Docket No. R97-1.

III. THE COMMISSION SHOULD USE THE ENGINEERED STANDARDS STUDY DATABASE IN ATTRIBUTING CITY CARRIER COSTS

In its initial brief, NAA endorsed the Postal Service's proposal to use the comprehensive and current data compiled by Mr. Raymond's Engineered Standards study in developing city carrier costs, as a significant improvement over the 1986 STS study which the Commission currently uses. NAA also supported the continued use of

the Commission's single subclass stop methodology for attributing city carrier access and coverage-related load time costs.²¹

Recycling previously rejected arguments, a number of parties (hereinafter the "Joint Parties") challenge the use of the new ES city carrier data.²² These arguments should be rejected for the same reasons set forth in the Presiding Officer's Ruling No. R2000-1/89 (July 14, 2000). The Presiding Officer's grounds for denying the joint motion to strike were sound, and *Advo et al.* offer no new argument at this late stage of the proceeding.²³

Similarly, the Joint Parties' attempts to discredit the ES study are without merit. They argue that the Commission should not employ the ES study in this proceeding for three basic reasons: (1) it was not designed for ratemaking purposes, (2) the ES data collectors were not sufficiently trained, and (3) the ES study overstates load time. While its initial brief (and that of the Postal Service) addressed these issues, NAA reiterates here that the level of detail and the methodology of the ES study make it superior to the STS study as a basis for ratemaking.

²¹ NAA does not take a position on the estimation of volume variable elemental load costs. NAA is sympathetic to the OCA's concern that the ES proportions, as reflected in Mr. Baron's steadily evolving proposals, have received little scrutiny on this record and may not be ripe for use in this case. See OCA Br. at 140-41 and Tr. 39/17820 (Kay) (showing declines in Mr. Baron's load time estimates).

²² See Joint Brief Concerning City Carrier Cost Attribution of *Advo, Inc. et al.*

²³ For the reasons set forth in its comments on the Joint Parties' motion to strike the testimony of witnesses Baron and Raymond, as well as in its briefs, NAA opposes the Joint Parties' last-ditch attempt to strike the testimony of witnesses Baron and Raymond by appealing to the full Commission the Presiding Officer's Ruling No. R2000-1/89.

The Postal Service should be commended for providing new and comprehensive evidence regarding *current* city carrier street activities, and the Commission should adopt the Service's proposal to use the ES database in lieu of the outdated 1986 STS study in this proceeding.

IV. CONCLUSION

For the foregoing reasons, and for the reasons stated in NAA's Initial Brief and in the Joint Brief concerning the SAI Report, NAA respectfully requests that the Commission issue a recommended decision consistent with the positions expressed herein and in our initial brief.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

September 22, 2000

William B. Baker
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